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Supreme Court of the United States

OCTOBER TERM, 1933.

No. 44.

L. M. DAKIN (SUCCESSOR TO A. M. ANDERSON), AS RECEIVER OF THE FIRST NATIONAL BANK OF ST. PETERSBURG,
Petitioner,

vs.

TAVER BAYLY, AS LIQUIDATOR OF THE PEOPLES BANK OF CLEARWATER, *Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

REPLY BRIEF OF PETITIONER TO RESPONDENT'S BRIEF.

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Your petitioner has heretofore approached the discussion of this case in his brief on the principle that the record discloses, on the face of the pleadings, that the indebtedness of the First National Bank of St. Petersburg to the Peoples Bank of Clearwater was an indebtedness owing to it as agent for its customers, inasmuch as the replication alleged that the items deposited with the Clearwater Bank by its customers were deposited for collection, which statement of fact is necessarily admitted by respondent's demurrer. (R. pp. 7, 8, 9, and 10.) These facts, supported by the record as indicated, were the basis for petitioner's

argument that items held under an agency relation, as distinguished from the relation of debtor-creditor, were not the proper subject of set-off. It now appears that a major portion of the brief of respondent discusses the question upon the theory that the Peoples Bank had accepted the drafts as payment and were liable to their customers under the doctrine established in Federal Reserve Bank v. Malloy, 264 U. S. 160.

This is a clear departure from the position of the respondent urged upon and sustained by the District Court and the Circuit Court of Appeals, and it was upon this record and this issue that petition for certiorari was asked of this Court. It is respectfully urged that the right to set-off on the basis of virtual ownership by reason of the alleged acceptance of the drafts as payment and alleged liability of the Clearwater Bank to its customers, for negligence under the Malloy case, not having been raised in the Court below, nor presented by the record, is not now properly before this Court for argument or determination.

We consider it a complete answer to the contention now made by respondent that, inasmuch as both banks are in receivership today, the customers of the Clearwater Bank have the option to elect whether they will proceed against the Clearwater Bank, under the doctrine announced in Federal Reserve Bank v. Malloy, 264 U. S. 160, upon the principle of liability for negligence, or against the National Bank by reason of their beneficial ownership of the collection items, in consequence of which they are entitled to follow such beneficial ownership into the drafts representing the collection items.

A careful reading of the Malloy Brothers case discloses by analogy that the Clearwater Bank could be liable to its customers only to the extent of the loss sustained through negligence in accepting drafts in lieu of cash or solvent credits. The customers of the Clearwater Bank not having made an election as to the remedy they will pursue, it follows that the liability of the Clearwater Bank upon the

theory of negligence has not yet been determined, and therefore the alleged consequent ownership of the Clearwater Bank in the drafts has not accrued or been determined. In this situation, assuming for discussion only, that potential liability under the Malloy doctrine does exist against the Clearwater Bank on behalf of its customers, the recourse of the Clearwater Bank against the St. Petersburg Bank would, of necessity, be by subrogation only to the rights of the customers of the Clearwater Bank against the National Bank upon the drafts in question. Such right of subrogation, not having at this date been fixed or determined, must necessarily arise, if at all, subsequent to the suspension of the National Bank, and as pointed out in Yardley v. Philler, 167 U. S. 344 and Scott v. Armstrong, 146 U. S. 499, such claim cannot be the subject of set-off, in view of the well-settled principle that the right to set-off is to be governed by the state of things existing at the moment of insolvency, and not by conditions thereafter created, and that claims acquired by assignment, purchase or subrogation after the appointment of a receiver are not a proper subject of set-off. McCandless v. Dyar, 34 Fed. (2) 989.

Respecting the contention of the respondent that the drafts were accepted by respondent as payment and that consequently respondent owned said drafts in its proprietary capacity and not as agent, we believe that Peoples National Bank v. Moore, 25 Fed. (2) 599, 601, is in point, wherein the Court holds that a draft accepted for collection items is not payment unless there is an express agreement that it is received as payment or unless there is clear and satisfactory proof of the intention that it is so received. There is nothing in the record in this case to indicate an express agreement that this draft was accepted as payment by the Clearwater Bank, nor that there was any intention that it would be accepted by that bank as final payment. Consequently it must be presumed from the record, as a matter of law, that the drafts were not accepted in payment

and that payment was not intended to result until the proceeds of the drafts had actually been received.

Respondent also contends that to allow the claim of the petitioner, without set-off, would not only require the Clearwater Bank to pay the National Bank receiver in full, but would also permit the Clearwater Bank to receive only dividends from the National Bank. This contention is not tenable, inasmuch as the suit of the National Bank receiver against the Clearwater Bank, likewise in liquidation, will have no other effect than to establish a claim against the Clearwater Bank (Merrill v. First National Bank of Jacksonville, 75 Fed. 148, 153; Bank of Bethel v. Pahquioque Bank, 14 Wall. 383, 402), upon which it will pay dividends to the St. Petersburg Bank as in the case of any other creditor of that bank. It results that the situation, in reality, will be that each bank will be entitled to and *will receive dividends* as follows: the Clearwater Bank, on behalf of its customers, to receive dividends from the St. Petersburg Bank, and the National Bank, in its own right (or on behalf of its customers as subsequent facts not here material may develop), to receive dividends on its claim against the Clearwater Bank. In this connection we desire to advise the Court that the statement on page 3 of petitioner's brief to the effect that "On the same day the First National Bank of St. Petersburg was indebted to the Peoples Bank of Clearwater", was intended to be stated: "On the same day the First National Bank of St. Petersburg was indebted to the customers of the Peoples Bank of Clearwater".

Respondent urges at page 7 of his brief that petitioner ultimately finds himself in the same identical position as respondent, and upon this theory reasons that the transaction establishes mutuality of parties. While this argument of respondent is not based upon facts disclosed by the record, the argument persuades us that the right to set-off would be still further removed from respondent if there were a *lack of beneficial ownership of the items with*

respect to both banks. (Thomas vs. Potter Title and Trust Co., 2 Fed. Supp. 12.) While the general rule of set-off indicates that mutual obligations between the same parties may be offset, the principle we now urge to this Court, and for which we expressly contend, is that the mutuality required must depend upon beneficial ownership of the obligations in question. We believe this Court so held in Central National Bank v. Connecticut Mutual Life Insurance Company, 104 U. S. 54, where the Court said at page 66:

> "But although the relation between the Bank and its depositor is that merely of debtor and creditor, and the balance due on the account is only a debt, yet the question is always open, to whom in equity does it beneficially belong? If the money deposited belonged to a third person, and was held by the depositor in a fiduciary capacity, its character is not changed by being placed to his credit in his bank account."

In conclusion your petitioner asserts that this offset should not be allowed for the reason that its allowance would effect an illegal preference in the application of the bank's assets, defeating the ratable distribution rule of the National Bank Act, for while it is conceded that where a legal right to set-off exists its allowance cannot be considered a preference, it cannot be doubted that the allowance of an illegal set-off constitutes an unlawful preference in that it improperly diminishes the trust fund of the general creditors by application of a portion thereof to effect the set-off claimed.

Respectfully submitted,

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